



Implementing Regulatory Reform

Foreign
Investment
Advisory
Service

REFORMING REGULATION IN SOUTH ASIA: EXPERIENCES AND POSSIBILITIES

*Andrew H. W.
Stone*

The World Bank



*Prepared for
the Third South
Asia Invest-
ment Round-
table on Best
Practice in
Implementing
Regulatory
Reform*

*Dhaka,
Bangladesh
13-14 June
2005*



Introduction: the need for better regulation

Good regulation and institutions help markets function and economies to grow. Good regulation does not mean no regulation. Essential regulation plays a critical role in raising tax revenues, protecting public health and safety, the environment, and the vulnerable. However, regulation should be limited to what is essential, effective and enforceable.

An effective legal and regulatory system strengthens incentives for formal participation in the economy, and reduces the costs. Yet international evidence suggests that poor economies, most in need of growth, tend to have more regulations. This lowers private sector productivity, encourages a higher degree of informal sector activity and corruption, and reduces employment growth.¹ Poor regulation (especially in tax and customs administration, registration, customs, licensing, labor markets) and arbitrary or complex enforcement practices elevate business costs and uncertainty, discouraging investment. Businesses realize these costs through direct payments (official and unofficial), and facilitation fees; but also in management and worker time devoted to compliance rather than core business functions.

The quantity and quality of regulatory and administrative controls in the economy influence investment decision and the basic costs, and hence the competitiveness, of businesses locating within a country. This note explores some examples of the South Asian experience with regulatory reform, then draws from global experience to suggest that more systematic and institutional approaches may be desirable.²

Well-intentioned efforts to protect public interests that were poorly designed and implemented have often borne heavy economic costs. For example, a recent study of Indian "protective" regulation designed to help workers indicated it actually hurt the poor, by impeding growth of demand for their work. The study of Indian States' manufacturing growth in the period 1958-1992 found that:

- states which amended the Industrial Disputes Act in a pro-worker direction experienced lowered output, employment, investment and productivity in registered (or formal) manufacturing;
- in contrast, output in unregistered or informal manufacturing increased;
- regulating in a pro-worker direction was also associated with increases in urban poverty; and
- this suggests that attempts to redress the balance of power between capital and labor can end up hurting the poor.³

Regulatory reform – what and why

The main aims of regulatory reform are to:

- remove barriers to entry and exit;
- reduce rigidities in labor markets;
- simplify tax systems (more transparent, less distortionary);
- strengthen property rights;
- rationalize and streamline licensing and registration; and
- remove or modify restrictive trade regulations.

Regulatory reform initiatives in a growing number of developed and middle income countries increasingly take an institutional approach, rather than merely focusing on individual rules and procedures. More and more, they focus on building capacity to

critically review and improve rules according to consistent criteria, including efficiency and fairness.

Predicted Gains from Reforms in South Asia

If firms in other cities could improve their investment climate to the level of Shanghai, the average productivity improvements would be:

- 18 % for firms in Bangalore;
- 43 % for Dhaka;
- 78 % for Calcutta;
- 81 % for Karachi; and

Key dimensions covered include power losses, customs delays and infrastructure connection delays.

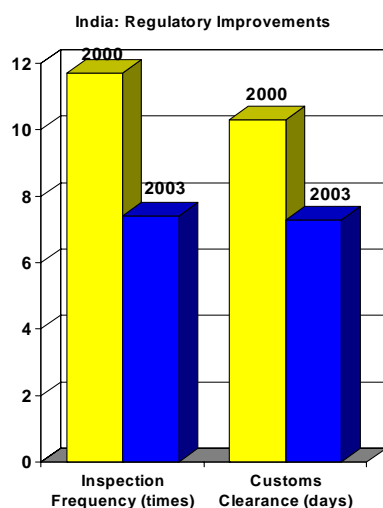
Source: David Dollar, Mary Hallward-Driemeier and Taye Mengistae *Investment Climate and Firm Performance in Developing Economies* (World Bank, 2003)

Regulatory reform affords major benefits for the economy and society at large. By reducing barriers to entry, it encourages growth and economic diversification via start-ups & small firms, complementing big investments. By reducing entry and operating costs, it reduces the share of enterprises operating informally, increases the tax base, allows for reducing the tax burden on other formal sector firms, and allows civil servants to switch to more useful tasks. Because regulatory burden often falls disproportionately on small and medium enterprises, regulatory reform disproportionately benefits small enterprises. Reducing or streamlining regulations shrinks bureaucratic discretion and hence helps to address the problem of corruption. Finally, it lowers the need for offsetting investment incentives and support measures, since it improves the underlying attractiveness of the economy for investment (both foreign and domestic).

South Asia is reforming regulations

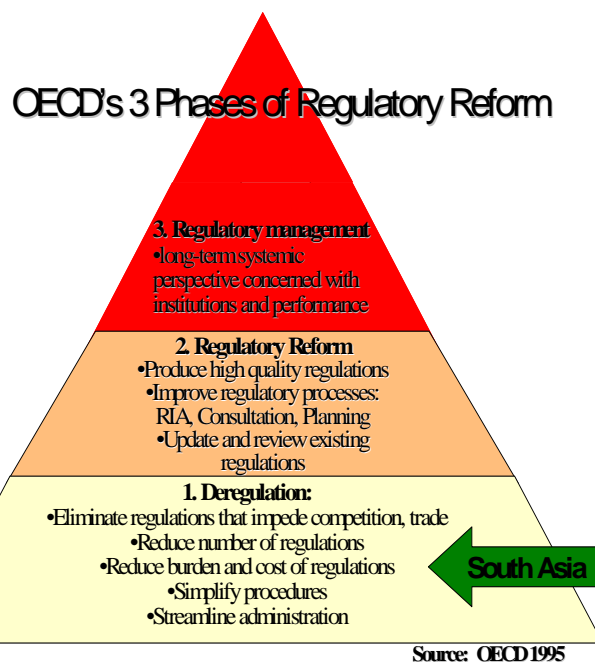
In a number of cases, South Asia has already begun reforming regulations. The many and wide-ranging examples include:

- widespread reform of tariffs;
- business regis-



- E-Governance initiatives such as land-titling in Andhra Pradesh and FDI project processing in Bangladesh; and
- the partial repeal in India of the Urban Land Ceiling and Regulation Act.

These initiatives have generally brought strong benefits and encouraged new investment.



Yet it is hard to point, in any country, to a *systematic and institutionalized* program of regulatory reform. There are several problems with approaching regulatory reforms one at a time. First, the sheer number of regulations may exceed the capability of reformers to address. Second, without a systematic approach, new regulations may be created faster than old ones can be improved or eliminated, thus increasing the burden on the economy. Third, individual efforts may not combine to form a coherent strategy that maximizes the benefits of resources invested to improve regulations. Finally, individual efforts may fail to build the capacity of government to assess and reform new and existing regulations over the long-term.

International experience

International experience suggests a number of possible approaches to reforming regulations throughout government, utilizing a strategic, programmatic approach. These vary from short-term drives for deregulation to long-term strategies for regulatory improvement. Three examples may help to illustrate the possibilities⁴.

Korea: Deregulation with a big bang

Motivated by the East Asian financial crisis of 1997, Korea launched a program of dramatic policy reforms in 1997. The East Asian financial crisis led Korea to introduce reforms to promote market efficiency and discipline, including reforms of the public sector, market regulations, the financial sector, the corporate sector and the labor markets.

Reforming Regulation: A spectrum of approaches

	Short-term	Medium-Term	Long-Term
Country	Korea	Hungary	Mexico
Description	"Big Bang"	"Guillotine"	"Intitutionalized"
Champion	Big push by President	Cabinet of Ministers	Initially President, then Min. of Trade
Goal	Reduce regulations by half	Eliminate unjustified regulations	From deregulation to good regulation
Context	Financial crisis	EU Accession	NAFTA
Means	Cross-cutting committee chaired by Prime Minister	Inter-ministerial committee, Justice Ministry review	Specialized Unit in powerful Ministry

In 1998, newly-elected President Kim Dae Jung expanded regulatory reform to all government sectors, and ordered Ministers to eliminate 50% of their regulations. The move was authorized under the previously approved "Basic Act on Administrative Regulation" (BAAR), which established principles for the review and reform of existing and new regulations. The initiative established a Regulatory Reform Committee (RRC) chaired by the Prime Minister with academic, private sector, foreign investor and consumer representation, as well as participation by relevant Ministers. Among its duties, it:

- established the direction for regulatory reform and related research and development;
- reviewed proposals for new or strengthened regulation;
- examined existing regulation, establishing a program for comprehensive regulatory review and reform of existing regulations;
- registered and published regulations;
- received opinions and suggestions on how to reform or revise regulations; and
- reviewed the status of regulations in each executive government agency.

Under direct orders from the President and Prime Minister, Ministers complied with the plan. They were to eliminate any regulations that served only

to hinder markets or competition, but modify those required to preserve the environment, public safety or health in order to achieve their goals as efficiently as possible. By the end of 1998, of 11,125 regulations in place prior to the Presidential order, 5,430 (48.8%) were eliminated, and another 2,411 (21.7%) were revised.

The impact was substantial. Ha (1999) estimated that over 10 years, these reforms would add 8.6% extra GDP growth, reduce consumer prices by 7.2%, and leave the unemployment rate 1% lower than it would have been without reform. Further, Korea's ranking in the Global Competitiveness Report rose from 48th out of 53 countries rated in 1997 to 26th out of 75 countries rated in 2002.

Unfortunately, the momentum of the initiative was not sustained, as popular and political support eroded. The initial focus on cutting the number of regulations (as opposed to substance) was criti-

Table 1. Numbers of Regulations 1998-2002 for All Government and Selected Ministries

	All Govt	MoW	MoCT	MoMA	MoA	MoCIE	FSC	MoE	MoFE
1998 (Initial Figures)	11125	1703	917	778	701	667	630	643	509
Eliminated in 1998	5430	857	467	422	362	345	315	224	255
Modified in 1998	2411	256	232	169	165	174	131	170	137
End of 1998*	6820	883	606	535	423	355	407	536	336
Eliminated in 1999	503	90	23	53	23	16	35	25	12
Modified in 1999	570	36	33	38	15	25	64	67	28
End of 1999*	6308	793	583	482	400	339	372	511	324
End of 2002*	7435	765	754	567	491	410	541	576	434
Percent reduction	PLEASE ADD								

Note: MoW = Ministry of Welfare, MoCT = Ministry of Construction and Transportation, MoMA = Ministry of Maritime Affairs, MoA = Ministry of Agriculture, MoCIE = Ministry of Commerce, Industry and Energy, FSC = Financial Supervisory Committee, MoE = Ministry of Environment, MoFE = Ministry of Finance and Environment

cized. Although the mechanisms established remained in place, progress slowed to crawl.

Hungary: La Guillotine

Immediately following the breakup of the former Soviet Union, Hungary launched the first of a series of efforts to deregulate and improve its legal and regulatory system, driven largely by the desire for EU accession. It began with *systematic reviews* focused first on deregulation -- removing poor laws, subordinate regulations, guidelines and local measures -- and then on improving public administration, efficiency and effectiveness.

The Guillotine scheme was authorized by the omnibus Deregulation Act. It called for automatic repeal after a prescribed date of all measures (or parts of laws and regulations) whose justification had not been submitted to and approved by De-

regulation Commissioners. The process involved the following steps:

- the Ministry of Justice prepared a full inventory of existing formalities;
- next, each line ministry was required to present a 3-year schedule for the assessment of older and then newer formalities; and
- over the 3-year period, Ministries then submitted justifications of formalities to be retained, along with recommendations of those (in whole or part) to be repealed or amended - in the latter case, they submitted draft text.

Commissioners evaluated this based on clearly-established criteria, either approving or rejecting the justification. The Ministry of Justice then issued a deregulation instrument to enact the Commission's decision. Ultimately, the commission's work was bundled into an omnibus Deregulation Act of 1990 that eliminated or reformed more than 150 laws and regulations. One important achievement of the first round was a dramatic simplification and reduction of licenses and permits. A second round of *guillotine* reviews took place in 1994-95, and the newly formed Commission included in its work the broader objective of improving the administration, efficiency and effectiveness of regulations. This new Commission targeted specific regulations, and then line ministries were given the opportunity to justify them. Again, regulations that could not be justified by an established date were repealed. However, this process was never fully institutionalized.

Mexico: Institutionalizing regulatory reform⁵

Beginning in 1989, motivated by impending trade liberalization under NAFTA, Mexico established an Economic Deregulation Unit (UDE) under its powerful Trade Ministry (SECOFI). Within UDE, a high-level professional group outside the traditional bureaucracy began to implement a radical new process. Its 15 economists and lawyers were accountable directly to the Trade Minister, with clear backing from the President. It first focused on fostering efficiency in the provision of non-traded services, focusing on sectors with high gains and/or low political costs. Among its achievements were:

- elimination of price and routing restrictions in trucking and bus transport (1989-90);
- legal basis for co-generation and self-supply by independent power producers (1992-93);
- legal basis for privately-run integrated port administrations (1991-93); and
- land tenure: Permitted sale of small land plots and promotion of agribusiness (1992).

By 1995, UDE moved from deregulation to a "better regulation" strategy to create appropriate market rules and institutions, and build more effective governance. A presidential decree ordered federal agencies to compile an inventory of business regulations and procedures, as well as proposals for reform, in a standard format. In 1996, UDE introduced systematic regulatory impact assessment (RIA) based on cost-benefit analysis. By 2000, to institutionalize and speed up the work of regulatory reform, the President reformed the Administrative Procedure Law. UDE became an autonomous body, called the Federal Regulatory Improvement Commission (COFEMER), with a bigger budget and staff.

Conclusion

Regulatory reform carries strong economic benefits, especially for the poor. South Asian economies have many problems due to poorly designed or implemented regulations. Thus far, while governments in the region have undertaken a large number of regulatory reforms, these reforms have not been institutionalized. International experience suggests that there are a variety of institutional approaches that could be adapted to contribute to a systematic and continuous improvement of business regulation, efficiency and effectiveness of regulations.

Notes:

1. World Bank, *Doing Business 2004*.
2. A number of related issues are not explored in this note, most notably the quality of governance and public administration, transparency and control of corruption, corporate governance and informal practices, and the legal system and rule of law.
3. Timothy Besley and Robin Burgess, "Can Labor Regulation Hinder Economic Performance? Evidence from India", *Quarterly Journal of Economics*, 119 (1), 2004.
4. The following examples are based on World Bank Group (FIAS/CIC) case studies prepared by Jacobs and Associates in 2004-2005.
5. This section is also based on Fernando Salas and Sunita Kikeri, *Regulatory Reform—Institution Building: Lessons from Mexico*, World Bank, Public Policy for the Private Sector, Note 282, January 2005.